

ANALYSIS OF ORIGINAL BILL

Author: Kaloogian & Baldwin Analyst: Kristina North Bill Number: AB 2110

Related Bills: None Telephone: 845-6978 Introduced Date: 02/18/98

Attorney: Doug Bramhall Sponsor:

SUBJECT: School Tuition Organization Credit/FTB Report Fiscal Impact To Legislature

SUMMARY

Under the Personal Income Tax Law (PITL) and Bank and Corporation Tax Law (B&CTL), this bill would authorize a credit to taxpayers equal to any voluntary cash contributions made to a school tuition organization.

EFFECTIVE DATE

This bill would apply to taxable or income years beginning on or after January 1, 1998.

SPECIFIC FINDINGS

Current state and federal laws generally do not allow a tax deduction for personal expenses, such as a child's educational expenses. Personal expenses that are deductible include items such as medical expenses, interest expenses, and taxes, and work-related expenses. Work-related expenses are deductible as miscellaneous itemized deductions, but only to the extent they exceed 2% of adjusted gross income (AGI). Expenses paid or incurred for the education of a child generally are not currently deductible, but would be considered a personal expense.

Federal and state laws allow a deduction for charitable contributions to various types of qualified organizations, including educational organizations.

Federal and state laws provide for various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child and dependent care credits) or to influence business practices and decisions. As modified by the Taxpayer Relief Act of 1997, federal law currently allows a Hope Scholarship credit and a lifetime learning credit for certain tuition expenses. However, state law does not currently allow a credit for tuition expenses.

Existing state law provides general rules which apply to all tax credits, unless the individual credit provisions specify otherwise. Among other items, general

DEPARTMENTS THAT MAY BE AFFECTED:

___ STATE MANDATE

___ GOVERNOR'S APPOINTMENT

Board Position:

___ S ___ O
___ SA ___ OUA
___ N ___ NP
___ NA ___ NAR
___X___ PENDING

Agency Secretary Position:

___ S ___ O
___ SA ___ OUA
___ N ___ NP
___ NA ___ NAR
DEFER TO ___

GOVERNOR'S OFFICE USE

Position Approved ___
Position Disapproved ___
Position Noted ___

Department Director

Gerald H. Goldberg

3/23/98

Agency Secretary

Date

By:

Date:

rules describe the division of credits between multiple taxpayers, a husband and wife, or partners. Except as specified, no tax credit may reduce regular tax below the tentative minimum tax for alternative minimum tax purposes.

This bill would allow a credit equal to any voluntary cash contributions made to a school tuition organization in this state, not to exceed \$500 per taxable year. The qualified contributions may not be designated by the taxpayer for the direct benefit of a taxpayer's dependent.

This bill defines a "school tuition organization" as a charitable organization in this state that is exempt under federal law and that allocates at least 90% of its annual revenue for educational scholarships or tuition grants. Recipients must be allowed to attend any qualified school of their parents' choice, and grants may not be limited to grants or scholarships to only students of one school.

This bill defines a "qualified school" as a primary or secondary school in this state that does not discriminate on the basis of race, color, sex, handicap, familial status or national origin and that satisfies the requirements prescribed by law for private schools on January 1, 1998.

This bill requires the Franchise Tax Board (FTB) to report on the fiscal impact of the credit to the Legislature on or before July 1, 2000.

This bill provides that, in the case of a husband and wife filing a separate return, the credit would be divided equally between them.

This bill provides the credit would be in lieu of any deduction to which the taxpayer would otherwise be entitled.

This bill would allow any unused credit to be carried over for five years.

Policy Considerations

This bill would provide an unprecedented 100% credit for qualified contributions up to \$500 per taxable year.

While single taxpayers would be allowed a \$500 credit, a husband and wife filing separately would be limited to \$250 each.

This bill does not contain a sunset date so the Legislature may review its effectiveness.

Implementation Considerations

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This bill provides a credit for voluntary cash contributions made to a school tuition organization, but does not provide a mechanism to verify the amount of contribution made by the taxpayer and whether the contribution was

distributed to a qualifying school. Therefore, this department would have difficulty processing this credit.

This bill requires that a school tuition organization must be a federally exempt charitable organization and "allocate at least 90% of its annual revenue for educational scholarships or tuition grants to children to allow them to attend any qualified school of their parents' choice" and the scholarships or grants are to be allocated "without limiting the availability to only students of one school." However, no verification process is provided certifying that 1) 90% of a charitable organization's revenue is allocated as required by this bill; 2) a school is of a parent's choice and 3) that the allocations have been made without limiting availability to students of one school. Without verification that a charitable organization meets these criteria, this department would have difficulty processing this credit.

This bill denies the credit if the taxpayer "designates" the donation for the "direct benefit" of any dependent of the taxpayer. These terms are not defined in the bill. Nothing prevents a school tuition organization from making educational scholarships or tuition grants to the children of a taxpayer on the basis of a taxpayer's contributions. These and other uncertainties may lead to disputes between taxpayers and the FTB concerning eligibility for the credit.

Technical Considerations

This credit is not allowed if the donation is designated for the direct benefit of any dependent of the taxpayer. Since corporate entities do not have dependents, the author may wish to modify the B&CTL language to include dependents of the taxpayer's key employees.

LEGISLATIVELY MANDATED REPORTS

The FTB would be required to prepare a report to the Legislature on the fiscal impact of the credits provided in this bill on or before July 1, 2000.

FISCAL IMPACT

Departmental Costs

If this bill is amended to resolve the implementation concerns, this bill should not significantly impact the department's costs.

Tax Revenue Estimate

Based on data and assumptions discussed below, this bill would result in revenue losses as shown in the following table:

Estimated Revenue Impact of AB 2110 Assumed To Be Implemented by 1999 (In \$Millions)			
Fiscal Years	1999/00	2000/01	2001/02
Revenue Impact	(10)	(12)	(14)

Any possible changes in employment, personal income, or gross state product that might result from this bill are not taken into account.

Tax Revenue Discussion

The potential revenue impact would be determined by the amount of approved credits and the tax liabilities of participating donors.

According to the Department of Education, there were over 4,300 private schools (grades K-12) in California during the school year 1996/97 with 615,000 students enrolled.

This proposal requires establishment of tax-exempt "school tuition organizations" that would collect donations, process student applications, and distribute the grants without limiting availability to only students of one school. It is assumed that because of the bill requirements pertaining to these tax-exempt organizations, the first year with a revenue impact would be 1999/00.

It is assumed that, since taxpayers cannot designate donations for the direct benefit of any of their dependents, participation levels per private schools would be insignificant. In order to estimate the potential magnitude of revenue losses, if, on average, five donors per qualified school contribute \$500 (maximum credit) during the taxable/income year (\$2,500 per school) and an 8% average marginal tax rate is used for the calculation of the deduction offset, the revenue loss for the first full fiscal year would be on the order of \$10 million, increasing by perhaps 15% annually.

It is projected that 90% of the potential revenue impact from this bill would occur under PITL and the remaining 10% under the B&CTL.

BOARD POSITION

Pending.